

# Financial Markets

- by Syndicate Group 5



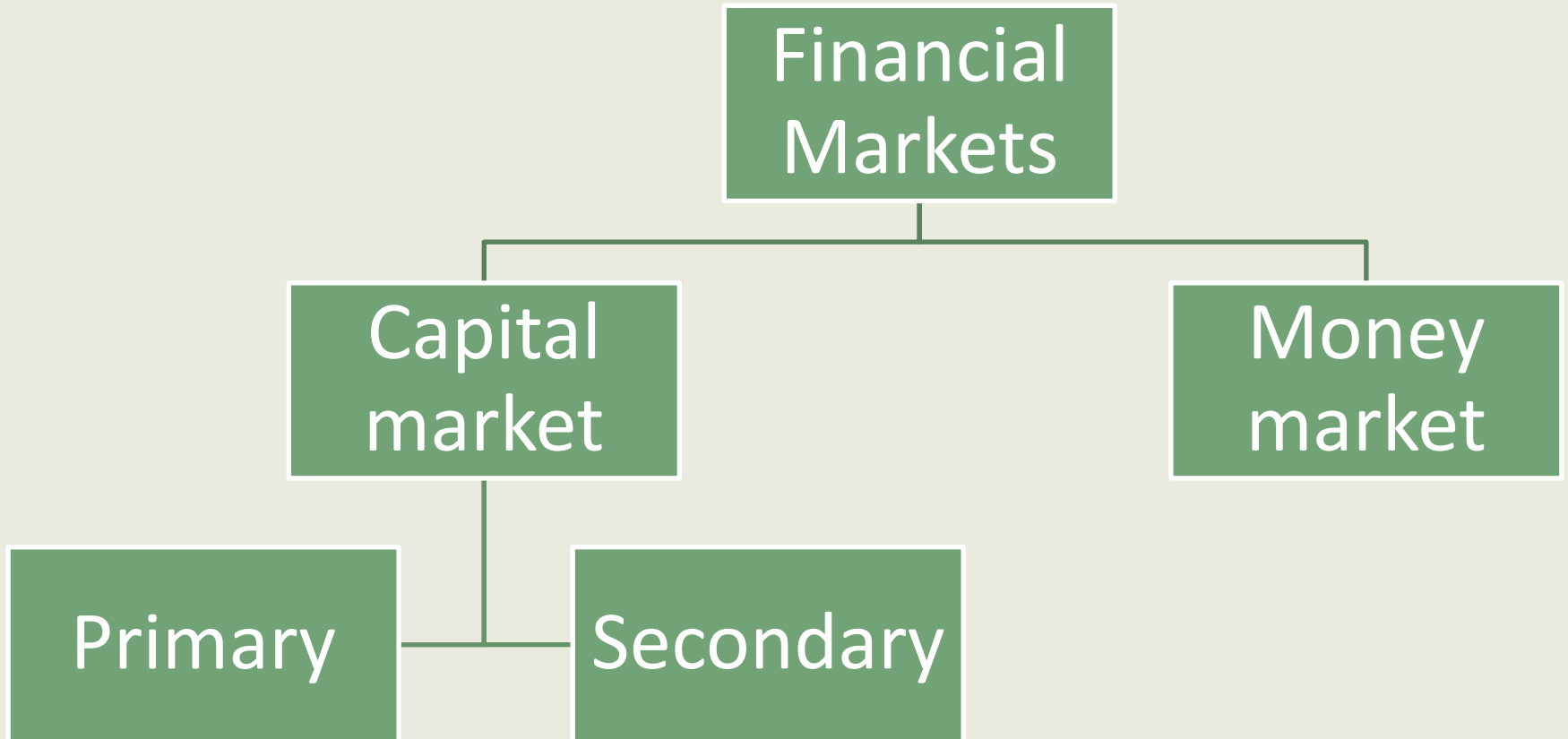
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# Financial Markets

- A market in which people trade financial securities, commodities, and other fungible items of value at low transaction costs and at prices that reflect supply and demand.
- Securities include stocks and bonds, and commodities include precious metals or agricultural goods.

# Types of Financial Markets



# Role of Financial Markets

*The former British Prime Minister William Gladstone expressed the importance of finance for the economy in 1858 as follows: "Finance is, as it were, the stomach of the country, from which all the other organs take their tone."*

- Mobilization of Savings
- Channelization into productive investments
- Facilitates Price Discovery
- Provides liquidity to Financial assets
- Reduces cost of transactions

# Role of Financial markets (contd..)

- Economic growth through better allocation of resources
- Raising capital for companies and governments
- Allows investors to invest in securities and earn returns
- Entrepreneurial growth
- Industrial development



# STOCK MARKET

# IMPORTANCE OF STOCK MARKET IN AN ECONOMY

- Raising capital for business
- Mobilizing savings for investment
- Corporate Governance
- Creating Investment opportunities for small investors
- Government capital raising for development projects
- Barometer of the economy

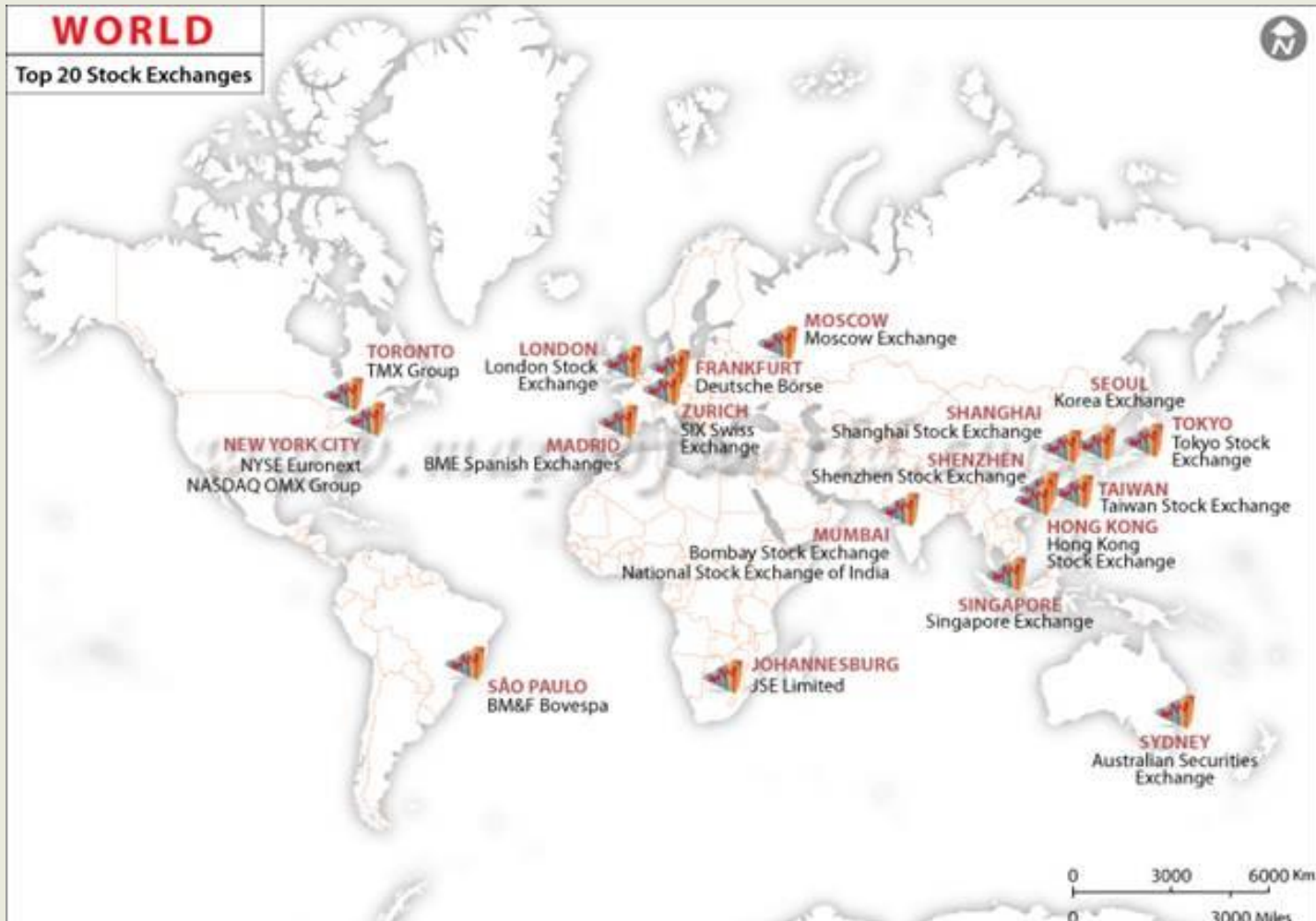


# DESIRABLE ROLE OF STOCK MARKET

- Liquidity
- Market Efficiency – Availability of information
- Price react quickly to new information
- Small price fluctuations

# WORLD

## Top 20 Stock Exchanges



# Fear of Finance

- **Financial crisis may arise because of:**
  - **Pessimistic Expectations → Self fulfilling crisis**
  - **Integrated nature of markets around the world (contagion effect)**
  - **Shock arising from one sector may soon spillover to other sectors → macroeconomic volatility**
  - **Speculation → Bubble → may burst**
  - **Regulatory failures**
  - **Uncertainty and herd behaviour**

# Crisis arising out of Financial markets

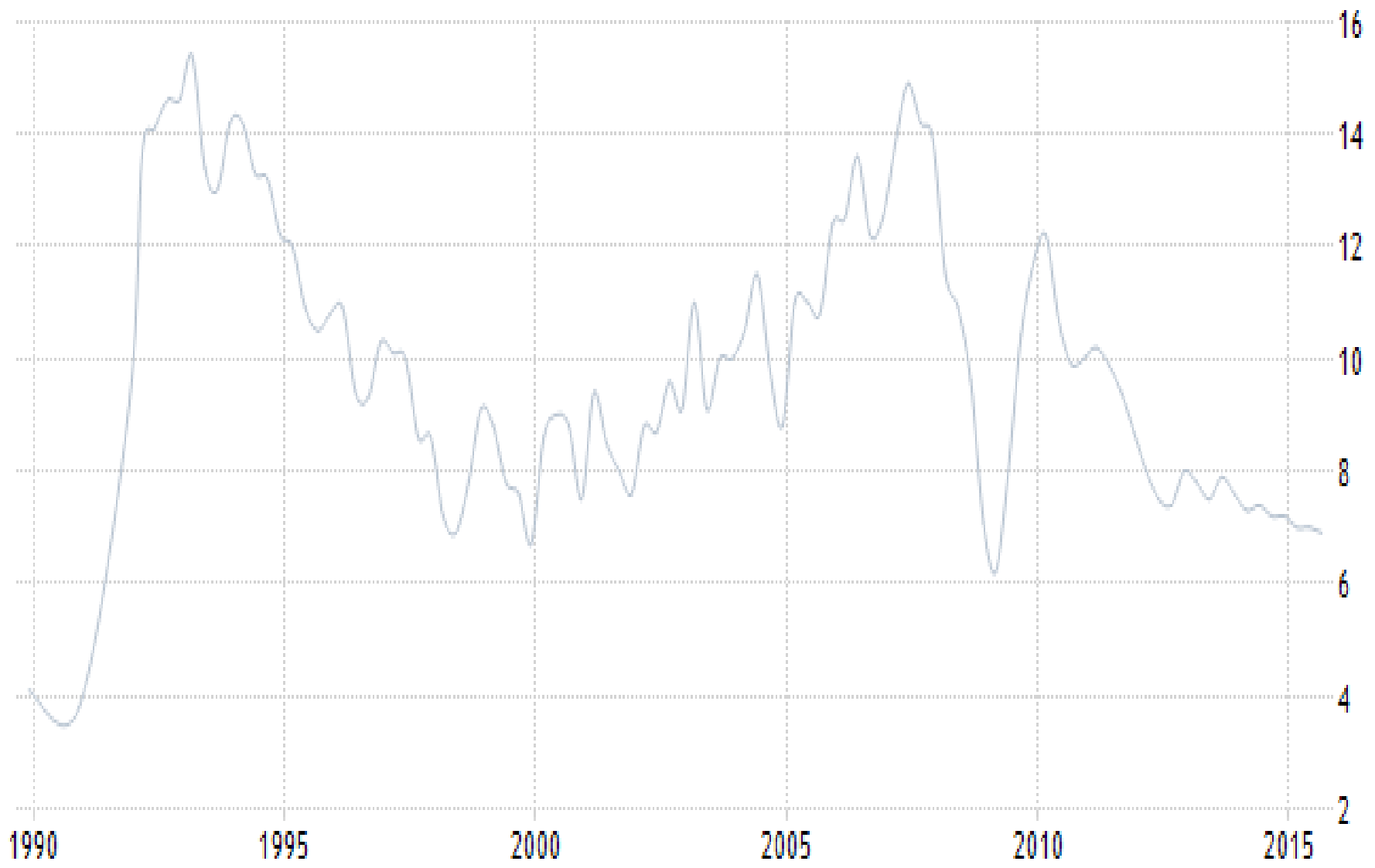
- “Tulip mania” – first recorded speculative bubble (17<sup>th</sup> century)
- 1997 East Asian Financial Crisis
- Dot com bubble (2000)
- US Financial Crisis (2008)
- China’s 2015 slowdown

# CHINESE ECONOMY

- World's Second largest economy by nominal GDP.
- For the past 30 years, China has grown at a rate of 10% per year with annual peaks of 13%.
- China's Rapid Growth is owed to its 1970s economic reform.
- Over the past five years, its growth has slowed to 7%.
- China's industrial sector has been shrinking at its fastest pace since 2009.
- For the month of July 2015, exports were down by 8.3% as compared to July 2014.
- IMF predicting China's economic growth to fall to 6.8% for 2015-16.



# CHINA GDP ANNUAL GROWTH RATE



# REASONS FOR THE MARKET FAILURE

**“China’s Stock market had become detached from the reality of China’s own economy”**

# REASONS FOR THE MARKET FAILURE

- Stocks had surged almost impeded.
- People bet heavily on stocks, often borrowing money to do so.
- Stocks rose even as the Chinese economy was slowing.
- Weak balance sheets and chronic problems with corporate governance were swept aside.
- Rally defied fundamentals, prompting concerns of a bubble.



## Shanghai Composite Index

**3,375.16** 1,084.72 47.36%

At market close 10/28/2015



Source: Reuters

The New York Times

# SEQUENCE OF EVENTS

## **26 June,2015**

- Drop of more than 7 percent in the shanghai and Shenzen markets.

## **27 June,2015 Onwards,**

- Chinese Central Bank responded with an interest rate-cut.
- Promised to investigate anyone involved in market manipulation
- Brokerage houses were ordered to pump billions of dollars into the market.
- Government-backed funds have earmarked billions more to prop up the shares of flagging companies.
- Stock trading transactions were slashed.
- China's insurance regulator eased rules so that insurers could more easily invest in stocks

# SEQUENCE OF EVENTS

## **8 July, 2015**

- China's Ministry of Finance pledged to “adopt measures to safeguard the stability of capital markets and in particular protect state-owned financial enterprises.”
- The move signals that this broad-based effort is being directed from the very top echelons of the state.

## **9 July,2015**

- Stocks rose after a series of market-propping government measures.

## **27 July,2015**

- Shanghai share index plunged 8.5%, its steepest one-day drop in eight years, casting doubt on government measures to support share prices.

**End of July saw, wiping out of \$3.5 trillion in wealth, more than the total value of India's Stock Market.**

# SEQUENCE OF EVENTS

## **In August,**

- China abruptly devalued its currency.

## **23 August, 2015**

- Pension Funds were approved for the first time to invest in stocks.

## **24 August, 2015**

- The benchmark shanghai composite index closed 8.5% lower, erasing all of the gains it had made in its extraordinary run-up this year.

# Global Impact

- Biggest importer of commodities, from countries like Australia and Brazil.
- Huge Buyer of Factory Equipment in Germany.

# Global Impact

Effect on Asia:

**“A decrease of 1 percentage point of China’s growth has been estimated by the World Bank to bring about a 0.2 percentage point decrease throughout the rest of Asia.”**

# Global Impact

- Indonesia is suffering from declining investment, weaker job creation and low fiscal revenues.
- Malaysia has been hurt by low natural resource commodity prices.
- Japan
  - second quarter drop in exports of 4.4%.
  - GDP growth has contracted by 0.4%.
- South Korea exports fell 6.4% in August compared to last year.

**Thank You !**

